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# **An integrative process model of organizational failure**

## **Abstract**

In spite of the perennial interest in organisational failure and burgeoning streams of research, much of the existing literature has developed in isolation across multiple social science disciplines. Consequently, this has obscured the past accomplishments and allowed confusion to persist. The review and synthesis of the literature across scholarly fields led to the development of an integrative process model of causes, stages of decline leading to failure and consequences of organisational failure. The proposed integrated framework brings together an array of theoretical explanations for the causes of business failure. The study uncovered uncharted territories and unresolved issues which have the potential to further illuminate our understanding of the subject. The study offers a number of contributions to theory and practice. **Keywords:** business failure; organizational failure; causes; processes; consequences

## **Introduction**

Over the past three decades, liquidation, discontinuance, bankruptcy and mortality studies, like many other branches of management, have coined specialised nomenclatures and approaches to describe organisational failure and its consequences (see Mellahi & Wilkinson, 2004; Evans & Borders, 2014; Cochran, Darrat & Elkhail, 2006). An unfortunate outcome has been that many non-specialists have lost touch with the advances made and key debates in the field (Mellahi & Wilkinson, 2010).

Over time, the burgeoning stream of research has become increasingly complex and fragmented across multiple social science disciplines including accounting, strategy, organisation studies, entrepreneurship and business history. Consequently, the lack of integration has not only failed to stimulate cross-fertilisation but also obscured the past accomplishments made in addressing the fundamental questions such as “why do firms fail?” and “what happens when firms fail?” Against this backdrop, confusion has emerged and the field is also “getting bigger without necessarily maturing” (Mellahi & Wilkinson, 2010, p. 532; Walsh & Bartunek, 2011). Although

past studies have called for a much integrated discussion on the causes of business failure (Mellahi & Wilkinson, 2004), to date, scholars have largely sidestepped the key issue.

The main purpose of this study is to review and synthesise the literature on the antecedents and consequences of organisational failure. The study makes at least two main contributions to the literature. First, in contrast to the much of the existing literature, this study develops an integrated process model which links the antecedents, stages of decline and consequences of organisational failure. In addition, the review of the literature helps in clarifying the various facets of the subject. It also led to the identification of a number of uncharted territories and unresolved issues with potential to further illuminate our understanding of the subject.

The rest of the paper is organised as follows. The next section sets out the definition of organisational failure and defines the scope of the review. This is then followed by an examination of the existing state of knowledge in the field. On the basis of the review and synthesis, the final section outlines directions for future research.

### **Defining organisational failure**

Over the years, some scholars have viewed organisational failure as either the discontinuance of the business (Hamilton, 2006; Walsh & Bartunek, 2011) or discontinuance of ownership of the business (Everett & Watson, 1998). Discontinuance of ownership may occur when the owner makes a decision to offload the firm and its assets to potential buyers or investors. One of the problems of viewing business failure as a discontinuance of business is that it primarily views failure as entry and exit rates (Everett & Watson, 1998). Many businesses often cease operations after the owners retire and therefore to equate such events to failure may not be an accurate reflection (Everett & Watson, 1998). In this context, organisational failure is defined as a situation where the firm ceases operations and loses its identity due to inability to respond and adapt to changes in the external environment in a timely fashion (Cameron, Sutton & Whetten, 1988; Hager, Galaskiewicz, Bielefeld & Pins, 1996). In other words, organisational failure refers to “the actual demise of the organization when an entire company goes out of business ... the

organization completely ceases to exist” (Marks & Vansteenkiste, 2008, p. 810). This definition excludes studies on firms experiencing temporary performance problems and then generates a turnaround.

### **Scope of the review**

In order to ensure a wider coverage of the literature, we replicated the systematic literature review approach advanced by Webster and Watson (2002) and Short (2009), and used by past reviewers such as Short, Ketchen, Shook and Ireland (2010). To assemble the literature, keywords such as discontinuance, insolvency, mortality, death, exit, failure, bankruptcy, liquidation, closure and setbacks, which have all been used to refer to organisational failure, were employed to search electronic databases such as Scopus, ProQuest, EBSCO Business Source Complete, Emerald, ScienceDirect, ISI Web of Knowledge and JSTOR. This approach was particularly useful in identifying and tracing past studies. The preliminary search resulted in the identification of a large number of articles which focused on the broad themes of failure including business, performance, service, system, operations and strategic failures. In order to further narrow down the voluminous number of studies with the general theme, additional keywords were employed in combinations (e.g. “failure”, “closure”, “bankruptcy”, “mortality” and “exit”). This process, in tandem with reading the abstracts and introductions of the articles, led to further elimination of studies outside the scope. This process paved the way for including studies where the focal firm ceases operations. In addition to the search of articles published in academic journals, working papers, a number of book chapters and conference proceedings were also examined for their inclusions to help ensure a comprehensive coverage of the literature. Thus, the study encompasses insights across multiple disciplines such as organisation studies, strategy and entrepreneurship to enrich our understanding of the current state of knowledge. Based on synthesis of the literature, an array of internal (firm-level) and external factors were identified which interacts to precipitate business failure. As outlined in Figure 1, these factors also influence the consequences of business failure. Below, we tease out the array of scholarly works uncovered.

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**Insert Figure 1 about here**  
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### **Organisational failure: An organising framework**

The review demonstrated that the theoretical and empirical research on the antecedents of organisational failure has tended to be polarised between the deterministic and voluntarist perspectives. A deterministic perspective in classical industrial organisation (IO) and organisation ecology (OE) literature suggests that managers are constrained by exogenous factors over which they have little or no control (Moulton, Thomas & Pruett, 1996). This suggests that organisational leaders are powerless in the face of changes in their environment. On the other hand, the voluntaristic perspective in organisation studies (OS) and organisational psychology (OP) literature suggests that managers' actions, inactions and perceptions are the fundamental causes of organisational failure (Mellahi & Wilkinson, 2004; Nutt, 1999, 2002). Appendix 1 provides a summary of studies on organisational failure across multiple disciplines. The table sets out some key findings from each study. Below, we expand on these pivotal findings.

### **Research on the external antecedents to organisational failure**

The classical IO traced its roots to the field of economics and assumed that a firm's management team can influence neither industry conditions nor the firm's own performance (Mellahi & Wilkinson, 2004). This perspective rests on the premise that firms cannot influence their own destiny. It argues that firms in an industry are affected by a range of industry-specific and environmental factors which lead to the process of "natural selection", whereby firms that do not fit their environment are "selected out" and "die" (Tirole, 1988). Therefore, organisational failure is seen as an inevitable consequence of the process of "natural selection" and "survival of the fittest". The following section outlines the variety of explanations for the causes.

### **Environmental jolts explanations**

One of the main streams of research on the external factors is anchored in the Schumpeterian thesis of "creative destruction" (Schumpeter, 1942). According to Schumpeter (1942), jolts in the

external environment can generate waves of organisational failure. Environmental jolts are “transient perturbations whose occurrences are difficult to foresee and whose impacts on organisations are disruptive and potentially inimical” (Meyer, 1982, p. 515). Past studies have identified two kinds of environmental jolts—beneficial and hostile (Meyer, 1982). On one hand, beneficial jolts can provide a safe setting and conditions for firms to thrive (Covin & Slevin, 1989). Beneficial jolts include a host of factors such as an increase in the customer population because of demographic changes, reduction in taxes, technological advancements and upswings in the business cycle, which may expand the economic opportunities for the population of firms within an economic niche (Venkataraman & Van de Ven, 1998). Consequently, such beneficial jolts can slow down or even avert the demise of firms (Carter & Van Auken, 2006).

On the other hand, hostile jolts such as a sudden increase in natural disasters, unexpected tax hikes, a drastic shrinkage in the customer population and downswings in the business cycle, may shrink the economic opportunities for the population of firms within an economic niche (Covin & Slevin, 1989; Bradley, Aldrich, Shepherd & Wiklund, 2011). Scholars in this area have uncovered that such adverse business conditions are more likely to lead to business failure (El Hennawy & Morris, 1983; Platt, 1989). It has been suggested that market forces through measures such as technological change, deregulation and liberalisation enable more efficient firms to drive out their less efficient competitors (Tirole, 1988; Silverman, Nickerson & Freeman, 1997). For instance, Silverman et al. (1997) examined the mortality of large motor carriers in the U.S. inter-state for the hire trucking industry after deregulation and found increased mortality when firms did not adhere to operating policies consistent with transaction cost minimisation principles. Indeed, firms are more likely to close when the environment is volatile and unstable (Anderson & Tushman, 2001; Swaminathan, 1996).

A large stream of research has suggested that organisation failure relates to the economic cycle (Platt, 1989; Platt & Platt, 1994; Carter & Van Auken, 2006). For instance, Bradley et al. (2010) conducted a study of Swedish manufacturing and technology firms and found that subsidiary

organisations have low mortality rates when compared to independent organisations, however, their mortality rates increase more rapidly during a severe economic downturn. As the economy worsens and recessions gather steam, the fortunes of big and small businesses often dwindle, which eventually precipitated their exits (Cornford, 2010).

### **Unfavourable environmental factors**

In addition to the above, researchers have uncovered that a host of unfavourable environmental factors such as competitive intensity, falling prices, price wars, withdrawal of government subsidies and tax relief lead to high failure rates of firms (Covin, Slevin & Heeley, 2000; Baum & Mezias, 1992; Platzer, 2015; Jones & Bouamane, 2012). This stream of research suggests that such adverse conditions precipitate the closure of less adaptive firms. One of the richest streams of research has documented an array of company collapses in the global solar photovoltaic (PV) industry (e.g. Jones & Bouamane, 2012). Some of the explanations offered for the demise of multiple firms include intense global competitive rivalry stemming from the increasing number of new entrants and precipitous decline of global prices for solar panels (Committee on Energy and Commerce (CEC), 2012; Platzer, 2015). In the 2000s, in an attempt to create and sustain a competitive industry and promote clean-energy production, the Chinese government injected state aid to help local solar manufacturers gain a foothold in the industry (Platzer, 2015; CEC, 2012). This has been instrumental in ushering in Chinese solar manufacturers to the global scene which coincided with the withdrawal of or reduction in subsidies by some Western countries (Platzer, 2015). Eventually, the cut-throat cost-cutting of Chinese rivals made it difficult for many Western-based solar companies to withstand the decreasing PV prices leading to the demise of multiple manufacturers in the industry (Platzer, 2015).

Studies indicate that the reduction or withdrawal of government subsidies to firms in countries such as the United States and Germany further exacerbated the financial position of some of industry players and precipitated the demise of companies such as Solyndra in the US, and Solar Millennium and Odersun in Germany (Jones & Bouamane, 2012). Indeed, intense domestic

(Baum & Mezias, 1992) and international competition (Platzer, 2015) has been found to lead to higher failure rates. In a nutshell, these broad categories of perspectives contend that failed firms are somehow unfortunate victims of external circumstances such as sudden changes in the environment over which they have no control.

### **Research on firm-level antecedents to organisational failure**

In recent decades, strategic management literature has shifted from viewing competitive advantage as primarily determined by environmental factors to internal organisational factors (Mahoney & Pandian, 1992). This shift has been attributed to the increasing recognition that sustained competitive advantage stems from the possession and utilisation of firm-specific resources and capabilities that are rare and cannot easily be imitated or substituted (Barney, 1991). Around about the same time, a parallel shift has occurred in studies of organisational failure where some scholars have shifted from viewing failure as stemming from the process of “natural selection” towards examining firm-specific factors leading to business failure (Nutt, 2002; Mellahi & Wilkinson, 2004). At the cornerstone of this research is the suggestion that failure stems from the actions and inactions of decision-makers (Sheppard, 1994a, 1994b; Nutt, 2002). The organisational antecedent perspective suggests that firm-specific factors to a greater extent are the primary causes of organisational failure (Mellahi & Wilkinson, 2010). This section articulates the various streams of research on firm-level antecedents.

### **Resource-based explanations**

A line of research rooted in the resource-based perspective of business failure (Hambrick & D’Aveni, 1992; Headd, 2003) has uncovered that the development, deployment and utilisation of resources and capabilities of firms are more likely to determine a firm’s ability to survive and avert ultimate failure. The review indicates that firm characteristics such as lack of quality resources and distinctive competencies are major contributory factors to failure (Carter & Van Auken, 2006; Headd, 2003). This also rests on the premise that talented executives enable their firms to phase out outdated skills and upgrade the expertise of workers in a timely manner to mitigate decline. Another interesting line of research has identified factors such as inability to



mobilise scarce human resources and lack of legitimacy (Fafchamps & Owens, 2009; Burger & Owens, 2013), depleted financial resources (Fernandez, 2008; Hager et al., 2004), lack of access to grants (Burger & Owens, 2013) and lack of connections to other organisations (Fernandez, 2008) as common reasons for organisational failure (Hager et al., 2004). Firms well-endowed with abundant and quality financial resources and human capital are less likely to fail relative to those with fewer resources (Headd, 2003).

Recent decades have witnessed a flourishing stream of research which suggests that failure may stem from the shrinking resources and expertise base of the firm (D'Aveni, 1990). Thus, organisational failure may stem from a lack of or declining financial and human capital to sustain a firm's operation (D'Aveni, 1990, 1989a, 1989b; Hambrick & D'Aveni, 1992). However, firms with inferior resources and capabilities are also more likely to lose their ability to compete and eventually exit the market (D'Aveni, 1989a, 1989b; Knott & Posen, 2005). Another line of research has attributed failure to factors such as limited prior experience, mismanagement and loss of key personnel (Burger & Owens, 2013; Hager et al., 2004). Thornhill and Amit (2003) suggested that firm-specific failure determinants such as managerial deficiencies may trigger bankruptcy.

### **The upper-echelon perspective explanations**

A stream of research anchored in the upper-echelon perspective (Hambrick & Mason, 1984) contends that organisational failures occur under the direction of top management teams (TMTs) and reflect imbalanced or inadequate expertise, inferior talent and disadvantageous social structure within the teams (D'Aveni, 1990; Platt & Platt, 2012). This stream of research highlights that top executives who are compositionally flawed are more likely to experience information processing deficiencies (Hambrick & D'Aveni, 1992). This then leads to strategic errors such as failure to gauge the seriousness of problems, and inability to identify market opportunities in a timely manner and respond to early warning signals of decline (Hambrick & D'Aveni, 1992). Studies indicate that strategic errors, miscalculations or blunders can be

attributed to team composition deficiencies (Nutt, 2002). These studies provide evidence of a link between top team characteristics and strategic error (Argenti, 1976; Nutt, 2002). A well-developed literature has demonstrated that firm-specific factors such as poor decision-making processes, poor strategic execution and lack of managerial foresight are primary antecedents of organisational failure (D'Aveni, 1990; Mellahi & Wilkinson, 2004; Moulton et al., 1996). Echoing these insights, Sheppard (1994a) examined the relationships between strategy and failure, and uncovered that, changes in business strategy to generate a turnaround, which are poorly formulated and executed by executives, may actually quicken the firm's demise.

In a related area, a line of research rooted in the organisational demography perspective (Pfeffer, 1983; Carroll & Harrison, 1998) has uncovered that demographic attributes of team members such as quality and differences in human capital held, educational level and length of service in an organisation can contribute to organisational failure (e.g. Hambrick & D'Aveni, 1992). Past studies have uncovered that long tenure of top executives can lead to strategic persistence even in the face of changes in the business environment (Amankwah-Amoah, 2014b). Such strategy may create conditions which eventually precipitate the exit of the firms.

A closely related stream of research has suggested that top managers can make a difference to the firm's survival. This is because their prestige influences the perceptions of important organisational stakeholders such as investors, shareholders and regulators, and their exit from financially troubled firms signals to stakeholders that the firm is no longer worthy of their support (D'Aveni, 1990; Sutton & Callahan, 1987; Semadeni, Cannella, Fraser & Lee, 2008). Indeed, the departure of the elite management team can undermine the legitimacy of the firm and its ability to attract stakeholders' support and thereby precipitating exit (Sutton & Callahan, 1987). A growing body of literature has demonstrated that factors such as over-widening ambition and weak management controls (Stead & Smallman, 1999), frequent changes in top management team (Amankwah-Amoah & Debrah, 2010), misallocation of resources and transfer of past bad practices (Amankwah-Amoah, 2014a) all contribute to the failure of firms.

## **Ecological explanations**

A voluminous stream of research anchored in the ecological perspective has uncovered that some firms are more likely to die than others due to liabilities of size, age and density (Burger & Owens, 2013; Carroll & Delacroix 1982; Hager et al., 2004; Hannan & Freeman, 1977, 1988; Hannan, 1988; Fafchamps & Owens, 2009). One of the most consistent findings in this area has been that younger firms are more likely to fail relative to older organisations (Stinchcombe, 1965; Hager et al., 1996). Past studies have indicated that about 40% of new firms fail to survive past the first year of operations (Taylor, 1999) and above 60% fail to survive for five years (Kirchhoff, 1994). Headd (2003) reported that about two-thirds of all firms survive two years and one half of new firms survive beyond four years. A well-articulated explanation is rooted in the liabilities of “newness” and “smallness”, terms coined by organisational theorist, Stinchcombe (1965). This is based on a premise that young and small firms often lack legitimacy and resources due to their limited track record, knowledge and expertise about the marketplace which puts them at a competitive disadvantage relative to established and large firms (Singh, House & Tucker, 1986a; Singh, Tucker & House, 1986b).

Largely due to their limited expertise, young firms are also forced to divert scarce resources away from operations to establish credibility and legitimacy in the eye of external stakeholders such as suppliers and customers (Carroll, 1983; Henderson, 1999). Such redirection of effort and resources has been identified as underpinning their high failure rate (Henderson, 1999). In addition, such new firms often exploit unproven and risky designs, strategies and technologies, which has been associated with their higher failure rates (Henderson, 1999). Prior research has shown that older and larger firms with greater networks of contacts and talented employees are more likely to improve their survival chances (Fafchamps & Owens, 2009; Hager et al., 2004). This stream of research has demonstrated that the risk of failure tends to decline with age as older firms gain more experience about the operating environment (Carroll & Delacroix, 1982; Singh et al., 1986a, b; Hager et al., 2004; Levinthal, 1991). Building on these findings, Thornhill and Amit (2003) uncovered that failure among younger firms can be attributed to deficiencies in

managerial knowledge and financial management abilities, whereas failure among older firms stems from inability to adapt to environmental change. Furthermore, young firms also lack slack financial resources which can buffer them against environmental challenges that threaten their survival (Bruderl & Schussler, 1990).

### **Liabilities of ageing hypothesis**

An alternative explanation has been advanced by some scholars who have argued that new firms suffer from a liability of adolescence rather than a liability of newness (e.g. Fichman & Levinthal, 1991). The liability of adolescence perspective contends that largely due to initial stocks of assets and resource endowments, new firms are able to survive for a time with little risk of failure (Bruderl & Schussler, 1990; Henderson, 1999). The initial resources then act as a cushion against minor shocks in the environment and thereby creating an “initial honeymoon period” (Fichman & Levinthal, 1991; Henderson, 1999). Consequently, as the initial resources dwindle years after their founding, such firms face higher failure rate. Over time, depletion of the initial resources in tandem with inability to adapt would eventually lead to exit.

Another school of thought is the liability of obsolescence which contends that failure rates increase as the firm ages (Barron, West & Hannan, 1994). Scholars have noted that “firms are highly inertial and tend to become increasingly misaligned with their environments” as they age (Henderson, 1999, p. 281; Barron et al., 1994). It has been uncovered that older and large firms are often bureaucratic and complex which then breeds inertia (Levinthal, 1991). This stifles their progress and ability to make necessary changes to respond to their environment which ultimately precipitates their decline and exit (Henderson, 1999). In an insightful study of the firms in the US personal computer industry, Henderson (1999) uncovered that firms that adopted proprietary strategists (i.e. use internally developed technologies) experienced liability of obsolescence, whereas firms that adopted the standards-based strategists (i.e. use technologies that conform with open and publicly available specifications) experienced a liability of adolescence. Based on

the above analysis, resource endowment and utilisation appears to provide a basis on which firms can mitigate the risk of failure.

### **Going beyond the internal vs. external debate**

As intuitively appealing as both of the deterministic and voluntarist perspectives might be in isolation, there has been an accumulated body of literature that suggests that an integration of both factors offers a much more robust explanation of the causes of organisational failure (Carter & Van Auken, 2006; Mellahi & Wilkinson, 2004; Pal, Medway & Byrom, 2006). Although the deterministic and voluntarist perspectives have some merits, each category of explanation in isolation offers only a limited picture of the causes of organisational failure. The review uncovered that a number of studies have integrated both perspectives to examine the causes of business failure (see Table 1, column 4). Indeed, there are also a myriad of case studies that have provided unique insights of firm-level and external factors leading to firm decline and exit (McGovern, 2007; Pal et al., 2006). On interactions, a nascent body of scholarly research has demonstrated that human capital decay (failure to update knowledge and expertise of decision-makers/managers/employees) leads poor understanding of the external environment, resource misallocation, and misdirection of managerial attention (e.g. Amankwah-Amoah, 2015). Another burgeoning body of scholarly works has suggested that poor information processes capability of decision-makers also leads to misallocation of resources and managerial attention (Amankwah-Amoah, 2015; Irani, Sharif & Love, 2001).

### **Stages of decline leading to failure**

A rich stream of research has consistently shown that the failure encompasses multiple stages of events, actions, inaction and responses. The process of decline can be seen as the shrinking and deterioration of resources and capabilities of the firm, which then causes it to lose legitimacy and ability to self-govern (Hager et al., 2004). According to Weitzel and Jonsson (1989, p. 94), “organizations enter the state of decline when they fail to anticipate, recognize, avoid, neutralize or adapt to external or internal pressures that threaten the organization's long-term survival.” The

review uncovered several stage models aimed at articulating the processes inherent in decline leading to failure (e.g. Sheppard & Chowdhury, 2005). For instance, Weitzel and Jonsson (1989) proposed a five-stage model of decline and generated different managerial implications for each stage. They contended that decline commences with “blinded management”; then “inaction”; followed by “faulty action”; then “crisis” and finally “dissolution”. Similarly, D’Aveni (1989) used the terms “sudden decline” and “gradual decline” to characterise the series of events that precipitate business exit. This view broadly emphasises early and late warning signals of decline leading to exit and managers’ failure to marshal adequate resources and expertise to respond to decline. Indeed, such managerial expertise and knowledge have been identified as essential ingredients in firms’ ability to scan their environment and timely upgrade obsolete routines, processes and resources in an attempt to mitigate failure (Cameron et al., 1988). Table 1 provides a summary of various studies that have offered a stage-based approach to the process of organisational decline leading to failure.

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Interestingly, however, studies have suggested that firms often have a substantial period of time to generate a turnaround before they fail (Hambrick & D’Aveni, 1988). Some firms can recover from a decline with a robust turnaround strategy to realign themselves with changes in the environment. However, others fail to adjust in a timely fashion and then enter “downward spirals” from which they do not escape (Cameron et al., 1988; Hambrick & D’Aveni, 1988). There is growing evidence, however, that human and social capital of top executives influenced the firm’s ability to slow down the pace of decline. D’Aveni (1990) suggested that failing firms’ attempts to improve their managerial prestige are sometimes hampered by “bailout”, where prestigious managers leave before their careers could be destroyed by the stigma of failure. It is worth noting that slack resources have been found to act as a buffer to cushion firms against sudden changes in the business environment (Levinthal, 1990). Firms lacking such critical resources may not be able to generate a downturn leading to untimely demise.

Another argument that has been advanced in the literature suggests that governments often deploy additional resource to avert the decline of state-owned firms. Therefore, such firms are more likely to experience a protracted period of decline before eventual exit (Amankwah-Amoah & Debrah, 2014). Even as organisational death becomes inevitable, some studies have demonstrated that dying firms also perform functions such as parting ceremonies to provide a mechanism to support each other and reaffirm their bonds (Harris & Sutton, 1986; Walsh & Glynn, 2008). Other organisational leaders have sought divine intervention through prayers to avert failure in the eleventh hour (Amankwah-Amoah, 2014a). Although environmental changes affect all firms, some firms are more capable than others of using their resources and capabilities to reduce mortality rates (Bradley et al., 2010). Although it has been well established that firms go through various stages prior to exiting, there remains a lack of consensus on the exact processes of decline leading to exit. In light of the review of the literature on stages of decline leading to exit, the study offers a sequential process model of business failure (see Figure 2). As shown in the figure, there are broadly five key stages in business failure leading to cessation of the business. The phase model entails how early warning signals emerged and if left unattended may ultimately interact with other factors to bring about the demise of the firm. It also demonstrates that the transition from one phase to the next is often punctuated by a number of actions and inactions by managers. During the late stage, the firm entered a critical condition referred to as the “downward spirals” leading to exit.

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### **Research on the consequences of organisational failure**

This section sets out the literature on the consequences of organisational failure. In recent years, scholars have turned to biological analogies such as “parent-progeny” effects (Phillips, 2002) and “sins of the father” effects (Amankwah-Amoah, 2014a) to shed light on how the effects of business failure can diffuse from one firm to another. Some scholars have employed the term “legacy organizational identity” to refer to the collective claim by former employees of defunct firms to form a unique identify (Walsh & Glynn, 2008). Recent research shows that there are

broadly two main effects of business failure: the contagion and competitive effects (Akhigbe, Martin & Whyte, 2005; Lang & Stulz, 1992).

### **The contagion effects**

The contagion effects contend that business failure unleashes a range of negative consequences for stakeholders such as employees, suppliers and shareholders (Lang & Stulz, 1992). This stream of research has identified effects such as loss of jobs stemming from failure, emotion and psychological burden that befall individuals (Shepherd, 2003, 2009; Byrne & Shepherd, 2015), diminished cumulative career advantages that befell former employees (Rider & Negro, 2015) and stigmatisation of individuals associated with failure (Goffman, 1963; Singh, Corner & Pavlovich, 2015; Wiesenfeld, Wurthmann & Hambrick, 2008). In much of the developing world, individuals involved in business failure are often labelled as “incompetent”, “squanderers”, “deceivers” and “cheaters” (see also Efrat, 2006b).

Another line of research has suggested that there is often a feeling of grief and loss of self-esteem after business failure as some former business owners come to the conclusion that they have personally failed in an area where they have made personal and financial commitments (Jenkins, Wiklund & Brundin, 2014). Historically, individuals have been subject to harsh treatment such as prohibition from holding public office, imprisonment and death as a consequence of business failure (Efrat, 2006b). In addition to the punishment of failure within the ambit of the law, society also delivered its own chastisement through public humiliation and stigmatisation (Sandage, 2005). This “baggage” which stems from past experience of failure and the fear of failure for a generation discouraged and hampered entrepreneurial activities (Efrat, 2006a, b; Isenberg, 2011).

Recent research has shown that the stigma surround failure has weakened (Evans & Borders, 2014; Sandage, 2005). One reason for the shift has been that society has come to accept that “failure might arise from risk rather than sin” (Kurunmäki & Miller, 2013, p. 1103). In the contemporary entrepreneurship literature, studies have indicated that the changing societal



perception and fading stigma of bankruptcy now provides more opportunities and space for individuals to start new businesses after failure (Shepherd & Haynie, 2011). Scholars have also come to recognise what Efrat (2002) referred to as the “fresh start” policy after business failure. This is where countries increasingly provide more opportunities for some businesses to recover after failure. One significant feature has been the evolution of laws and regulations exemplified by Chapter 11 of the Bankruptcy Code in the US (Evans & Green, 2000; Ma, 2001).

Interestingly enough, there has been a shift from the “old-fashioned sense” of failure where failed companies immediately closed doors and cleared out shop-floors, towards a more tolerant view where opportunities are provided for former employees to recover (Shepherd & Haynie, 2011). Isenberg (2011, p. 36) succinctly summarised the current challenges and the changing attitudes towards failure by noting that: “many countries, even those with advanced economies, inadvertently discourage entrepreneurship by punishing bankruptcy. They prevent failed entrepreneurs from conducting future business or even opening bank accounts, and in some cases treat bankruptcy as a crime”. One recent and promising stream of research has suggested that when firms die, their faulty resources, routines and processes can be transferred to existing firms through personnel mobility (Phillips, 2002; Ferriani, Garnsey & Lorenzoni, 2012). Eventually, this often leads to performance decline and the exit of some firms (Phillips, 2002). One school of thought – the spillover theory of business failure (Platt, 1989; Akhigbe, Martin & Whyte, 2005) – argues that business failure in one industry has the potential to precipitate the demise of firms in other industries. Platt’s (1989, p. 107) study uncovered that “for vertically integrated industries, failure rates of selling industries are positively associated with failure rates in buying industries”.

### **The competitive effect**

The competitive effect contends that business failure is some kind of beneficial environmental jolt which unleashes waves of positive effects to be tapped by existing firms. The demise of an incumbent creates competitive space for rival firms as well as enlarges the market opportunities

for the population of firms within an industry (Carter & Van Auken, 2006). One stream of research has identified the diffusion of knowledge of skilled employees from departed to existing firms as one of the major consequences of business failure (Knott & Posen, 2005; Hoetker & Agarwal, 2007). This line of thinking suggests that failure enables firms to acquire top talent cheaply rather than incurring astronomical training costs in some industries. As such, the failure of a major firm in the industry provides the opportunity for others to acquire ready-made talent (Isenberg, 2011). More firms have come to view others' failure as an opportunity to tap customers released by the departed firm (Delacroix & Carroll, 1983; Pe'er & Vertinsky, 2008) and benefit from the sudden decrease in the number of competitors (Carter & Van Auken, 2006).

Another stream of research has suggested that business failure also provides a wake-up opportunity for firms to learn from others' misfortunes (Shepherd, 2003), higher stock returns and new customer orders (Lang & Stulz, 1992). A recent study also indicates that firms are more likely to learn more from failure than success (Desai, 2011). The existing streams of scholarly works, however, provide us with few insights into factors that prompt a firm to seek to recruit employees of failed firms. Future study could enrich our understanding of this phenomenon. For decades, firms have sought to avert failure by distancing themselves from failed rivals and allies as a means of improving their chances of success. Yet, one active line of contemporary research has suggested that firms can benefit from others' failure by luring competent former employers to help improve their processes (Amankwah-Amoah, 2013).

### **Discussion and conclusion**

The study sought to review and synthesise the literature on the antecedents and consequences of organisational failure. In so doing, we advanced an integrative process model of the antecedents, stages of decline leading to failure and consequences of organisational failure. The study demonstrated multiple accomplishments and progress made in enhancing our understanding of the subject. As the review has shown, some scholars have focused on the prolonged debate about whether the causes of failure can be attributed to internal or external factors. Business failure

may stem from firm-specific (endogenous) and external environmental (exogenous) factors. One promising development in the literature is an emerging consensus that businesses often failed due to interaction of firm-specific and external factors. The review indicates that the integrated approach offers a more robust explanation of the causes of failure.

Although most studies have focused on the causes of failure, there has been a fundamental shift towards examining the consequences of organisational failure. In this direction, studies have uncovered two broad categories of effects, i.e. the contagion and competitive effects. In addition, there has also been a shift from viewing business failure as mainly having negative outcomes towards exploring how failure provides opportunities for other firms to learn and benefit from others' misfortunes (Knott & Posen, 2005). The paper has shown that research on the subject has grown and continues to delve further into more complex issues such as how existing firms can capture the positive effects of failure.

### **Contributions and directions for future research**

The paper makes key contributions to the business strategy, organisation studies and organisational failure literature. First, in spite of the perennial interest in the subject, the lack of integration has obscured the progress made by scholars. By reviewing the literature in an integrative manner across multiple disciplines, the study offers paths towards a better understanding of the antecedents, stages of decline and consequences of organisational failure. Thus, the study responds to the call by Mellahi and Wilkinson (2010) for a more integrated approach to fragmented literature that has hindered the past accomplishments. Another way that this study differs from and extends past research is that it brings further clarity on the current state of knowledge with regard to some of the fundamental questions such as “why do firms fail?” and “what happens when firms fail?”.

The study suggests a number of fruitful avenues that can be pursued to further enrich our understanding of the subject. First of all, a promising avenue lies in exploring whether stigmatisation after business failure fades away with the passage of time. Such analysis could

provide further insight into the long-term effects of business failure as well as shed light on how both positive and negative attributions manifest after failure. These relationships have been largely overlooked by the existing streams of research. Future research should seek to examine how organisations can benefit from others' failure without exposing themselves to the contagion effects. Another possible direction would be to examine whether the pace of decline affects other firms' ability to capture the positive externalities of failure. Notwithstanding the above important insights, there has been a conspicuous lack of clarity in this area which warrants further scholarly attention. In contrast to the copious research on the causes on organisational failure, limited attention has been paid to the interactive effects of the internal and external factors. An important next step would be to examine the mechanisms through which sudden changes in the external environment can cause firms' level of expertise and knowledge to become obsolete, leading to business failure.

From a practical standpoint, the findings suggest the need for firms to proactively scan their environment in order to identify early warning signals of decline to help avert collapse. Despite the benefits of learning from the experiences of other firms (Baumard & Starbuck, 2005), there remains an unwillingness on the part of existing firms to recruit former employees of collapsed companies. As such, often former employees' knowledge decays with the passage of time. The study highlights the inherent benefits of learning from other firms' failures to not only improve firms' competitiveness but also to avoid falling into the same trap. These observations also suggest that strategies to learn from failure can facilitate the diffusion of useful knowledge from the departed firm to existing firms. By articulating key features of the subject, we hope this study would help foster a much better informed discussion and ignite further research on the subject.

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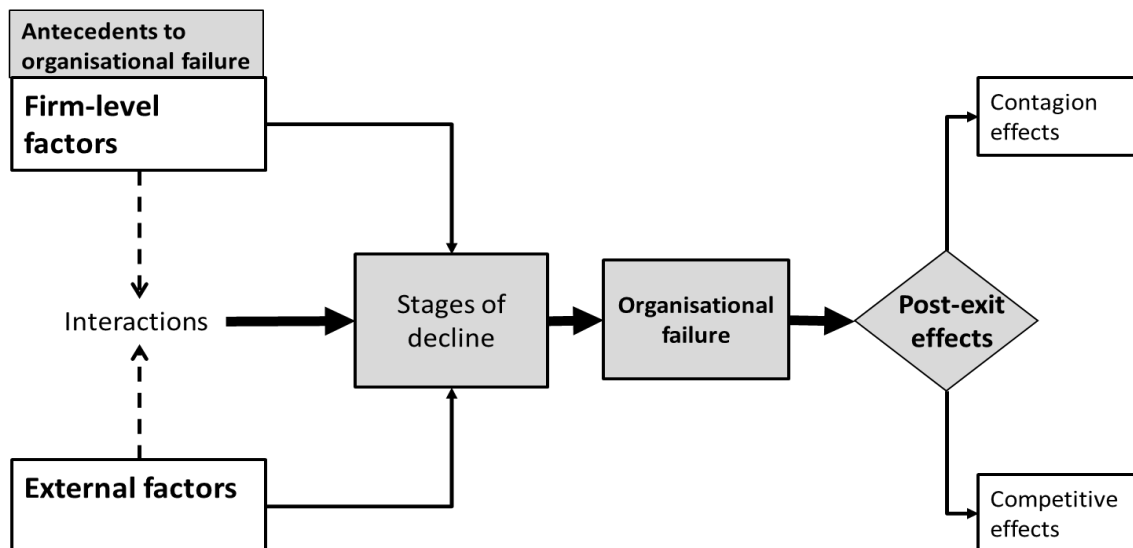
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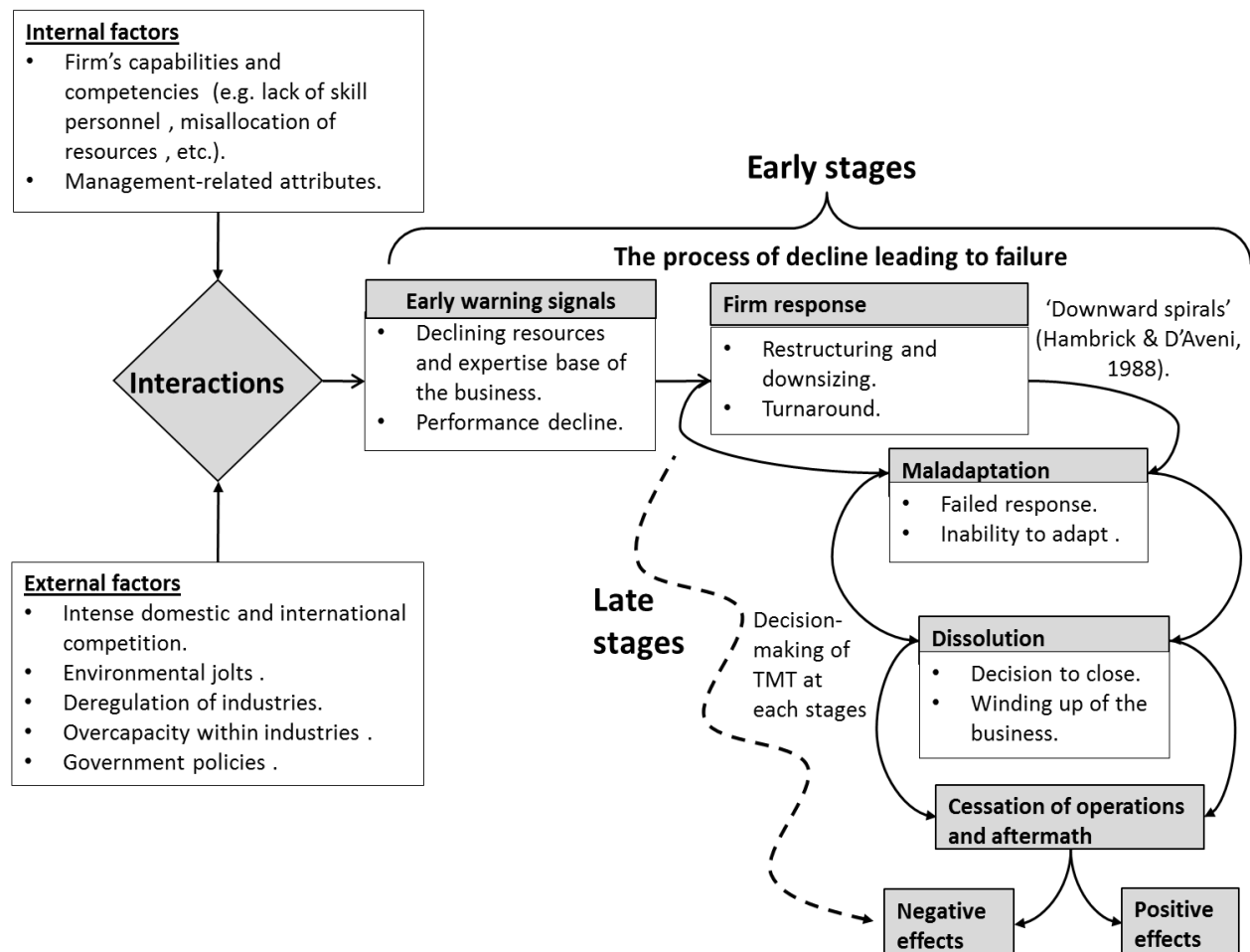
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**Figure 1: An integrative process framework of organisational failure research**



**Figure 2: A sequential process of organisational failure**



### Appendix: Summary of some empirical research on organisational failure

Studies/Year	Level of Analysis	Data source	Theoretical Lens	Key findings
Amankwah-Amoah & Debrah (2010)	Antecedents	A case study of a state-owned airline: Ghana Airways.	IO and OS	<ul style="list-style-type: none"> <li>External and internal factors such as liberalisation and frequent changes to the top-management team contributed significantly to failure.</li> </ul>
Amankwah-Amoah & Debrah (2014)	Antecedents	A collapse of Air Afrique.	IO and OS	<ul style="list-style-type: none"> <li>Failure stems from conflicting interests of the multiple stakeholders and inability to respond to sudden changes in the business environment.</li> </ul>
Baum & Mezias (1992)	Antecedents	Failures in the Manhattan hotel industry from 1898 to 1990.	DBM	<ul style="list-style-type: none"> <li>Firms located in densely populated regions of firms experience significantly higher failure rates.</li> </ul>
Carter & Van Auken (2006)	Antecedents	Compared 57 bankrupt small firms to 55 non-bankrupt firms.	OF	<ul style="list-style-type: none"> <li>The most serious problems of bankrupt firms can be condensed into three categories: lack of knowledge, inaccessibility to debt and economic climate.</li> </ul>
D'Aveni & MacMillan (1990)	Antecedents	57 bankrupt firms and 57 matched survivors.	OF and CM	<ul style="list-style-type: none"> <li>Failing firms deny crises and avoid focusing on long-term problems because of short-run resource constraints and threat-rigidity response.</li> </ul>
Hambrick & D'Aveni (1988)	Antecedents	57 large bankruptcies and 57 matched survivors from manufacturing, retail and transportation firms.	OF and UET	<ul style="list-style-type: none"> <li>Failing firms tend to engage in vacillating or widely swinging strategic behaviours. Decision makers often delude themselves into believing that a problem does not exist or that it is not serious.</li> </ul>
Hambrick & D'Aveni	Antecedents	57 large bankruptcies and 57 matched survivors from publicly	UET	<ul style="list-style-type: none"> <li>Deterioration of the top-management team is a central element of the downward spiral of large corporate</li> </ul>

(1992)		traded firms filing bankruptcy petitions during 1972–1982.		failures. Team deficiencies bring about corporate deterioration either through strategic errors or stakeholder uneasiness with the flawed team.
D'Aveni (1990)	Antecedents and consequences	57 large bankrupt firms and 57 matched firms selected from industries in the US economy from 1972 to 1982.	UET	<ul style="list-style-type: none"> <li>Failing firms are often unable to hold onto gains because of the "bailout" (where prestigious managers leave before their careers are destroyed by the stigma of failure) in the last two years before bankruptcy.</li> </ul>
Hamilton (2006)	Antecedents	Three American firms: Enron, ValuJet and Arthur Andersen, LLP.	OF	<ul style="list-style-type: none"> <li>Loss of legitimacy identified as major factor in business failure.</li> </ul>
Hollow (2014)	Antecedents	The case of the Birkbeck Bank	Strategic inertia	<ul style="list-style-type: none"> <li>Inability to adapt and respond to market conditions and change in a timely manner ultimately precipitated its demise.</li> </ul>
McGovern (2007)	Antecedents	A case study of the Decline of Dunlop.	IO and OS	<ul style="list-style-type: none"> <li>Management failed to develop appropriate strategies to jolts which led to large losses in an industry suffering from overcapacity.</li> </ul>
Moulton, Thomas & Pruett (1996)	Antecedents	Compared 73 firms that declared bankruptcy from 1980 to 1986 with the behaviour of 73 matching surviving firms over the same period.	IO, EO and OS	<ul style="list-style-type: none"> <li>Although firms failed under all possible combinations of firm and industry growth or decline, this study found that more failed in growing than declining industries. Debt-funded, forced-growth strategies create a high risk of failure regardless of industry growth rate.</li> </ul>
Pal et al. (2006)	Antecedents	A case study of A. Goldberg & Sons Plc.	IO and OS	<ul style="list-style-type: none"> <li>Various internal and external pressures including over-expansion into new retail space and the general economic downturn contributed to failure.</li> </ul>

Sheppard (1994)	Antecedents	Commerce Clearinghouse Capital Changes Reporter for companies which declared bankruptcy during the period 1980 to 1987.	The IO	<ul style="list-style-type: none"> <li>The financial resources of failed firms were weaker than their surviving counterparts for a long period of time (up to five years) prior to actual bankruptcy.</li> </ul>
Singh, Corner & Pavlovich (2015)	Antecedents and consequences	Based on 12 cases of entrepreneurial failures in New Zealand.	Failure stigmatisation	<ul style="list-style-type: none"> <li>The process of stigmatisation often commences “before, not after” business failure has occurred.</li> </ul>
Thornhill & Amit (2003)	Antecedents	Data from 339 Canadian corporate bankruptcies.	RBV	<ul style="list-style-type: none"> <li>Younger firms fail due to deficiencies in managerial knowledge and financial management abilities. However, failure among older firms stems from inability to adapt to environmental change.</li> </ul>

**Note:** In the Theoretical Lens column: OF: Organisational failure; OL: Organisational learning; OK: Organisational knowledge; KS: Knowledge spillover/diffusion; AT: Agency theory; RBV: Resource-based view; TL: Turnaround literature; PT: Prospect theory; UET: Upper echelon theory; PET: Population ecology theory; SAP: Selection and adaptation perspectives; OE: Organisational ecology; NE: Neoclassical economics; TCE: Transaction cost economic; IO: The industrial organisation; OS: Organisation studies; OC: Organisational crisis; DBM: Density-based models of inter-organisational competition; CM: Crisis management.

**Table 1: Comparison of stage perspectives of organisational failure**

Study	Stage characteristics
Mellahi (2005)	<ul style="list-style-type: none"><li>• The stages include conception, warning signals, rebellion and collapse stage.</li></ul>
Sheppard and Chowdhury (2005)	<ul style="list-style-type: none"><li>• A four-stage model (i.e. decline; response initiation; transition; outcome) is used to describe the trajectory which leads to failure or turnaround.</li></ul>
Amankwah-Amoah and Debrah (2014)	<ul style="list-style-type: none"><li>• The stages identified include golden age; Africanisation; escalating indecision; escalating commitment; and dissolution.</li></ul>
D'Aveni (1989)	<ul style="list-style-type: none"><li>• “Sudden decline” and “gradual decline” are two types of decline leading to exit.</li></ul>
Weitzel and Jonsson (1989)	<ul style="list-style-type: none"><li>• Proposed a five-stage model of decline which commences with “blinded management”; then “inaction”; followed by “faulty action”; then “crisis” and finally “dissolution”.</li></ul>